

Message Text

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LONDON FOR SEITZ

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TAGS: ECON, EAID, KE, UNCTAD, OPIC

SUBJECT: KENYAN ECONOMIC REVIEW AND 1976 PROSPECTS

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1. SUMMARY. RECENT DISPUTE BETWEEN KENYA AND UGANDA OVER PRES. AMIN'S TERRITORIAL CLAIMS, AS WELL AS UPCOMING UNCTAD IV (MAY 3-28), DICTATES TIMELINESS OF UPDATING DEPARTMENT'S INFORMATION ON CURRENT ECONOMIC SITUATION IN KENYA. A DECLINE IN AGRICULTURAL PRODUCTION AND A CONTINUING BALANCE OF PAYMENTS DEFICIT (NOW ESTIMATED AT \$45 MILLION FOR 1975)
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THROTTLED KENYA'S 1975 ECONOMIC GROWTH AND, DISPUTE RISING

COFFEE PRICES, THREATEN TO DEPRESS THE 1976 PERFORMANCE. CAPITAL GRANTS AND DEVELOPMENT LOANS FROM MULTILATERAL SOURCES, AS WELL AS TRADITIONAL DONOR NATIONS, HAVE OFFSET TRADE IMBALANCE WITHOUT GOK RESORTING TO RAPID DRAIN ON FOREIGN EXCHANGE RESERVES. GDP ROSE ABOUT 3 PERCENT, SHORT OF THE GOK FORECAST RATE OF 5.5 PERCENT, AND WAY BEHIND THE 7 PERCENT ANNUAL INCREASES EXPERIENCED DURING THE 1960'S. GOVERNMENT ECONOMISTS ARE PREDICTING A 5.5 PERCENT TO 6 PERCENT GROWTH IN 1976, BASED MAINLY ON ANTICIPATED INCREASES IN AGRICULTURAL PRODUCTION. UNLESS KENYA MANAGES TO REDUCE A FORMIDABLE BALANCE OF TRADE GAP (\$400 MILLION IN 1975), AND STIMULATE DOMESTIC INDUSTRIAL ACTIVITY, IT IS DIFFICULT TO IMAGINE ECONOMIC GROWTH EXCEEDING 3.5 PERCENT. END SUMMARY.

2. TRADE. ESTIMATES OF KENYA'S IMPORT BILL FOR 1975 APPROACHED \$1100 MILLION, UP SLIGHTLY FROM 1974'S FIGURE OF \$1035 MILLION. VOLUME OF IMPORTS DROPPED 15-20 PERCENT OVER 1974. GOK IMPORT RESTRICTIONS DESERVE SOME CREDIT IN HOLDING DOWN 1975 EXPENSES, BUT THE MODEST GROWTH IS DUE PRINCIPALLY TO FACT THAT BUSINESSES WERE ABLE TO DRAW DOWN ON LARGE 1974 INVENTORIES. NOTABLE IMPORT REDUCTIONS WERE EXPERINCED IN TEXTILES, IRON AND STEEL PRODUCTS, AND PASSENGER VEHICLES.

3. EXPORT REVENUES, WHILE ABOVE 1974 FIGURES, SHOWED A DISAPPOINTINGLY SLUGGISH GROWTH IN 1975. AGRICULTURAL PRODUCTION, DOWN 6 PERCENT IN REAL TERMS DUE POOR WEATHER CONDITIONS AND HIGHER PRODUCER COSTS, FAILED TO SATISFY DOMESTIC DEMAND, MUCH LESS ENCOURAGE EXPORTABLES. COFFEE, COUNTRY'S MAIN EXPORT COMMODITY, SUFFERED ITS THIRD YEAR OF DROUGHT. KENYA'S 1974/75 CROP WAS AUCTIONED OFF BEFORE POST-FROST PRICE BOOM, AND 1975/76 CROP HAS ONLY JUST BEGUN TO TAKE ADVANTAGE OF SUPERIOR MARKET CONDITIONS. TOTAL EXPORT VALUE NEARED \$700 MILLION, LEAVING A \$400 MILLION TRADE GAP ON MERCHANDISE ACCOUNT. PETROLEUM PRODUCTS, THOUGH, THANKS TO SOARING WORLD PRICES, ARE FAST BECOMING KENYA'S MAJOR EXCHANGE EARNER, CONTRIBUTING OVER 20 PERCENT OF TRADE REVENUE. IMPORTS OF PETROLEUM AND PETROLEUM PRODUCTS IN 1975, AN EXPENSE

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PARTIALLY OFFSET BY THE \$149 MILLION EARNED FROM EXPORTS OF REFINED PETROLEUM PRODUCTS. INTERNAL CONSUMPTION OF NEARLY ALL TYPES OF FUEL DECLINED OVER YEAR, BY AS MUCH AS 20 PERCENT IN CASE OF INDUSTRIAL DIESEL OIL. FUEL PRICES COULD SERIOUSLY RETARD HOPED-FOR EXPANSION OF INDUSTRIAL ACTIVITY IN 1976, PARTICULARLY IF GOVERNMENT PRICE CONTROL DECISIONS DO NOT PROVIDE GREATER FLEXIBILITY TO MANUFACTURING FIRMS ALREADY SQUEEZED BY A VARIETY OF

INPUT COSTS. KENYA'S TRADE WITH FELLOW EAC STATE FELL 2 PERCENT, A REFLECTION BOTH OF DETERIORATING ECONOMIC CONDITIONS IN ALL THREE STATES AND A GENERAL DECLINE IN RELATIVE IMPORTANCE OF EAC INTERSTATE COMMERCE.

4. TOURISM. DESPITE ECONOMIC RECESSION IN EUROPE AND U.S. AND STEADILY INCREASING TRANSPORTATION COSTS, THE TOURIST SECTOR MANAGED A 12 PERCENT INCREASE IN TOTAL RECEIPTS. GOK ESTIMATES THAT TOTAL INVISIBLES NETTED \$148 MILLION IN 1975 (USING PRE-DEVALUATION EXCHANGE RATE), A 15 PERCENT INCREASE OVER 1974 RECEIPTS. SUSPICION THAT SUBSTANTIAL SUMS ARE BEING DIVERTED TO OVERSEAS BANK ACCOUNTS SEEMED TO PROMPT WIDELY-PUBLICIZED GOK WARNINGS TO SERVICE INDUSTRIES THAT FOREIGN CURRENCY BE EXCHANGED ONLY IN BANKS OR MAJOR HOTELS. HOTELS AND TOURIST AGENCIES ARE ALSO OBLIGED TO ACCEPT PAYMENT IN KENYA FOR THEIR SERVICES. TOURIST TRADE IS REPORTEDLY LOSING THE BIG-SPENDERS IN THE GAME-PARK CIRCUIT, MOSTLY AMERICANS, BUT PICKING UP EUROPEAN PACKAGE TOURS HEADED FOR LESS COSTLY COASTAL RESORTS. IF TRUE, CONTINUED GROWTH OF THIS SECTOR WILL DEPEND ON LARGER VOLUME OF VISITORS EACH YEAR AND EXPANSION OF PROMOTION FACILITIES IN EUROPE TO ATTRACT MIDDLE CLASS CLIENTELE.

5. INVESTMENT. DOUBLE-DIGIT INFLATION AND UNSTEADY MANUFACTURING OUTPUT IN SOME CASES INHIBITED PRIVATE INVESTMENT SPENDING. ON BRIGHT SECTOR WAS TEXTILE PRODUCTION AND SALES (THANKS TO SIGNIFICANT REDUCTION OF IMPORTS). DIVERSIFICATION IN ITEMS OF PRODUCTION AS WELL AS NEW MANUFACTURING CAPACITY BROUGHT ON STREAM IN LATE 1974 BY SEVERAL LARGE MILLS BOOSTED LOCAL OUTPUT. COTTON YARN PRODUCTION ROSE 90 PERCENT AND COTTON WOVEN FABRICS 20.5 PERCENT. DECLINES IN OUTPUT OF MANUFACTURED UNCLASSIFIED

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FOOD PRODUCTS, WHICH ACCOUNT FOR ABOUT 20 PERCENT OF TOTAL MANUFACTURED OUTPUT, WERE ATTRIBUTABLE MAINLY TO SUPPLY SHORTAGES. DAIRY PRODUCTS, MAIZE AND WHEAT FLOUR, AND MEAT PRODUCTS ALL FELL FROM 1974 LEVELS.

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6. ALTHOUGH OUTPUT OF BUILDING AND CONSTRUCTION INDUSTRIES REMAINED AT 1974 LEVELS, ACTIVITY IN THIS SECTOR WAS SHARPLY REDUCED BY RISE IN BUILDING COSTS, CREDIT RESTRICTIONS, AND GENERAL ECONOMIC RECESSION. BUILDING COSTS, ESCALATING BETWEEN 3.5 AND 9 PERCENT MONTHLY THROUGH 1975 WERE MODERATE COMPARED TO 1974 INCREASES. SIGNIFICANTLY HIGHER WAGE COSTS AND INFLATED PRICES OF IMPORTED MATERIALS WERE BLAMED; HOWEVER, GOVERNMENT OBSERVERS EXPECT A STABILIZATION OF INPUT EXPENSES IN 1976.

7. MONETARY SECTOR (INTERNAL). MONEY SUPPLY, IN RESPONSE TO AN INDIFFERENT ECONOMIC PERFORMANCE AND DRAW-DOWN OF UNCLASSIFIED

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1974 INVENTORIES, REGISTERED A MODEST 6 PERCENT INCREASE. LOANS AND ADVANCES BY COMMERCIAL BANKS ROSE 8 PERCENT, BUT IN REAL TERMS (DISCOUNTING FOR PRICE INFLATION) BOTH CHANGES REALLY REPRESENT SMALL DECREASES. GOK BORROWING CONSUMED ALMOST 20 PERCENT OF 1975 BANK CREDIT

AND QUADRUPLED IN VALUE OVER 1974. GOK HAS MADE VALIANT EFFORTS TO RESTRAIN RECURRING EXPENDINGURES, BUT DEVELOPMENT SERVICES COSTS ROSE 40 PERCENT FROM FY74 TO FY75. FY75'S BUDGET DEFICIT OF \$19 MILLION WILL PROBABLY BE SURPASSED IN FY76 AGAIN DUE TO HEAVY DEVELOPMENT EXPENDITURES. THIRD QUARTER FY 1975 SPENDING EXCEEDED RECEIPTS BY \$35 MILLION.

8. DOMESTIC CREDIT AVAILABLE AFTER FINANCING GOK'S DEFICIT BUDGET WAS ALLOCATED TO PRIORITY SECTORS SUCH AS AGRICULTURE AND MANUFACTURING. IMPORTERS RELIED INSTEAD ON EXPORT AND SUPPLIERS CREDITS AS WELL AS OVERSEAS BANK BORROWING. GOVERNMENT ATTEMPTS TO STIMULATE PRIVATE SAVINGS BY RAISING MINIMUM DEPOSIT AND LENDING RATES AND BY FIXING TREASURY BILL DISCOUNT RATE FAILED TO MOBILIZE ADDITIONAL FINANCIAL RESOURCES. AS NOTED IN CENTRAL BANK'S ANNUAL REPORT, PEOPLE APPEARED TO MAINTAIN STANDARDS OF LIVING BY DEPLETING SAVINGS IN SPITE OF HIGH INTEREST RATES ON DEPOSITS. PRICE INFLATION CONTINUED TO ERODE REAL GROWTH IN INCOMES, GENERATING SUBSTANTIAL WAGE CLAIMS AND SETTLEMENTS DESPITE GOK INCOME-RESTRAINT POLICIES. OFFICIAL ESTIMATES OF CONSUMER PRICE INCREASES RANGE FROM 13 TO 16 PERCENT; HOWEVER, A MORE REASONABLE FIGURE WOULD BE AT LEAST 20 PERCENT IN URBAN AREAS. FARM INCOMES WERE SLIGHTLY BETTER OFF THANKS TO PRICE INCREASES GRANTED BY GOK TO ENCOURAGE AGRICULTURAL PRODUCTION. SUCCESS OF OCTOBER'S DEVALUATION IN RESTRAINING IMPORTS CANNOT BE MEASURED UNTIL LATER IN 1976, ALTHOUGH ITS IMPACT ON CONSUMER PRICES WAS EVIDENT IN RAPID MARK-UPS AT RETAIL LEVEL ON WIDE RANGE OF FOREIGN GOODS. PRICE CEILING ON PETROLEUM PRODUCTS WAS RAISED IN DECEMBER TO TAKE ACCOUNT OF HIGHER CRUDE COSTS AS WELL AS NEW CURRENCY RATE.

9. MONETARY SECTOR (EXTERNAL). FOREIGN EXCHANGE RESERVES GREW DURING FIRST QUARTER OF 1975 BUT FELL STEADILY
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FROM APRIL TOWARDS THEIR RECORD 1974 LOW. DECEMBER 1975 LEVEL OF \$168.6 MILLION REPRESENTED TWO-MONTHS IMPORT COVERAGE. JANUARY 1976 RESERVE LEVEL (MINUS SDR ACCOUNT) DIPPED TO 148 MILLION. TO HELP COVER 1975 PAYMENTS DEFICIT OF CLOSE TO \$45 MILLION, KENYA RECEIVED ABOUT \$43 MILLION IN IMF CREDITS, NOTABLY FROM THE EXTENDED FUND FACILITY AND 1975 OIL FACILITY. OVER \$300 MILLION WAS RECEIVED IN LOAN COMMITMENTS FROM BILATERAL AND MULTILATERAL SOURCES, A HEFTY SUM WHICH SHOULD PRECLUDE THE NEED TO SLASH THE DEVELOPMENT BUDGET IN ORDER TO PAY IMPORT BILLS.

10. PROSPECTS FOR 1976. GOK IS COUNTING ON CLIMBING COFFEE PRICES TO KEEP TRADE DEFICIT WITHIN MANAGEABLE PROPORTIONS IN 1976. INCREASED EXPORT VOLUME, COUPLED WITH AVERAGE MARKET PRICES ALREADY 60 PERCENT ABOVE LAST YEAR, COULD PRODUCE BETWEEN \$15 AND 20 MILLION EXTRA REVENUE. ON THE OTHER HAND, ANOTHER TEN PERCENT INCREASE IN CLUDE OIL COULD RAISE KENYA'S NET IMPORT BILL (SUBTRACTING REFINED OIL EXPORTS) BY \$10 TO 12 MILLION. SUCCESS OF DEVELOPED COUNTRIES IN CONTROLLING DOMESTIC PRICE INFLATION COULD BENEFIT KENYA THROUGH STABLIZED IMPORT COSTS. NEVERTHELESS, 1976'S IMPORT BILL WILL NOT BE RESTRAINED AS IN 1975 BY INVENTORY ACCUMULATION DURING PREVIOUS YEAR AND THREATENS TO WIDEN CURRENT ACCOUNT DEFICIT DESPITE GOK EXCHANGE RESTRICTIONS. CAPITAL ACCOUNT WILL REPRESENT LARGE PLUS ITEM AS GOK DRAWS HEAVILY ON DEVELOPMENT LOAN AND GRANT COMMITMENTS. OFFICIAL ESTIMATES REACH AS HIGH AS \$294 MILLION FOR 1976. DEBT SERVICE PAYMENTS WILL CONTINUE TO RISE OVER NEXT DECADE; HOWEVER, ACCORDING TO IBRD PREDICTIONS, BORROWING PLANS SHOULD NOT PUSH DEBT-SERVICE RATIO BEYOND 20 PERCENT (CURRENT FIGURE 6 PERCENT). NEVERTHELESS, GOK DEFICIT SPENDING WILL BE MAJOR PROBLEM IN 1976 UNLESS GOVERNMENT TAKES POLITICALLY UNPOPULAR DECISION TO SLASH DEVELOPMENT PROGRAMS. AT CURRENT RATE OF EXPENDITURE, DEFICIT COULD REACH \$27 MILLION. INFLATION, FUELED BY RISING IMPORT COSTS, HIGHER AGRICULTURAL COMMODITY PRICES, AND URBAN WAGE INCREASES WILL PLAGUE KENYAN ECONOMY ANOTHER YEAR. FATE OF EAST AFRICAN COMMUNITY, CURRENTLY UNDER YEAR-LONG REVIEW BY HIGH-LEVEL UNCLASSIFIED

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TRI-STATE COMMITTEE, COULD CONCEIVABLY ALSO HAVE SERIOUS IMPACT ON KENYA'S FOREIGN EXCHANGE POSITION, TRADE RELATIONS, AND INVESTMENT PROGRAMS. DISSOLUTION OF COMMON SERVICES, ALONE, WOULD INTRODUCE PROBLEM OF APPORTIONING ASSETS IN EQUITABLE MANNER AMONG THREE COUNTRIES. WITH SUCH AN UNCERTAIN ECONOMIC FUTURE, KENYA WILL BE VOCAL PARTICIPANT IN LDC APPEALS FOR COMPENSATORY FINANCING SCHEMES, COMMODITY PRICE SUPPORTS, AND INCREASED DEVELOPMENT AID. MARSHALL

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